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No. 426

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

STEPHEN J. LEONARD

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above-entitled cause on July 20, 1939, reversing the decision of the Board of Tax Appeals.

OPINION BELOW

The opinion of the Board of Tax Appeals (R. 21–39) is reported in 36 B. T. A. 563. The opinion of the Circuit Court of Appeals (R. 152) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 20, 1939 (R. 155–156). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer is taxable upon income payable to his divorced wife for her support and maintenance from a trust created by him, pending her suit for divorce, in connection with a separation agreement which was thereafter approved by the New York divorce decree, even if the divorce court lacked power to award further alimony?

2. In the alternative, whether under New York law the decree of divorce terminated the husband's duty of support and substituted finally therefor the provisions of the agreements incorporated in the decree?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 9–12.

STATEMENT

The material facts, as found by the Board of Tax Appeals (R. 23–31), are as follows:

On December 27, 1928 the wife of the taxpayer, who was then living apart from him, began suit for divorce against him in New York (R. 23–24). While this action was pending, the taxpayer and

his wife executed a deed of trust and a separation agreement, both on June 4, 1929 (R. 24, 26).

The deed conveyed securities and cash valued at $650,000 from the taxpayer to a trustee in trust to pay the net income to the beneficiaries therein named in equal monthly installments so far as practicable. (R. 24.) During the life of the wife, the trustee was to pay from the net income $5,000 per year to each of three named children or to the wife as guardian during their minority. The remaining net income was payable to the wife for her support and maintenance. (R. 25.)

The separation agreement incorporated by reference the deed of trust and recited the expectation of both parties that the wife would receive $30,000 per year from the aggregate net income from the trust and from property given to her by the taxpayer in the past. (R. 26–28.) The taxpayer promised to make additional payments of $35,000 per year to his wife for life, provided his circumstances and ability to pay continued as good as of that date, so as to bring the total allowance for her support and maintenance to $65,000 per year. (R. 28.) The wife accepted the establishment of the trust fund and the payments to be made pursuant to the separation agreement in lieu of all dower and released any claim of dower in the property of the taxpayer. (R. 29.)

The divorce decree became final October 22, 1929. The court incorporated the agreements in the de-

cree, "approved and affirmed" the same, and directed the taxpayer to pay his wife $35,000 per annum during her life. (R. 30.)

Between June 4 and December 31, 1929, the trustee received income of $16,191.34 from the trust property. It distributed $5,200 to the wife and five-twelfths of $5,000, or $2,083.33, to each of the three children, leaving an undistributed balance for that period of about $4,700. (R. 31.) The Commissioner included all of this income in the taxpayer's taxable income for 1929. (R. 31, 22–23.) Upon review, the Board of Tax Appeals held that only the amounts actually distributed to taxpayer's wife and minor children were taxable to him and that the portions paid to his adult daughter and undistributed were not so taxable. Both the Commissioner and the taxpayer appealed, and the court below, reversing the decision of the Board, held that although the taxpayer was taxable on income payable to his minor children, he was not taxable on income payable to the wife.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer was not taxable upon trust income payable to his wife for her support and maintenance under the terms of the trust agreement here involved.

(2) In failing to hold the taxpayer taxable under *Douglas* v. *Willcuts*, 296 U. S. 1.

(3) In holding that *Douglas* v. *Willcuts* is inapplicable unless by state law the divorce court retains power to change its original alimony award.

(4) In not holding that under New York law the terms of the instant divorce decree regarding support of the wife may be changed or modified as justice may require.

(5) In failing to affirm and in reversing the decision of the Board of Tax Appeals insofar as it held that the taxpayer is taxable on trust income paid to his wife.

(6) In affirming and in not reversing the decision of the Board of Tax Appeals insofar as it held the taxpayer not taxable on trust income received in 1929 and currently distributable to the wife but not actually distributed during the taxable year.

REASONS FOR GRANTING THE WRIT

1. This petition presents substantially the same issue as *Helvering* v. *Fitch*, No. 243, present term, in which the Government has applied for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Eighth Circuit in *Fitch* v. *Commissioner*, 103 F. (2d) 702.

The issue common to this case and to the *Fitch* case is also presented in *Commissioner* v. *Fuller*, decided June 30, 1939, in which a petition for certiorari is also being filed by the Government to review the judgment of the Circuit Court of Appeals for the Second Circuit.

Reference is made to the petition filed in the *Fitch* case for the reasons for granting the writ requested.

There is a difference in the cases in that here a small portion of the trust income was not distributed during the taxable year whereas all of the income involved in the *Fitch* and the *Fuller* cases was actually so distributed. It is thought that this difference has no legal significance and in this respect our view is supported by the decision of the court below, which held (R. 155) that the taxpayer was taxable on income payable to the minor children even though not all of it was distributed during the taxable year. Cf. *Freuler* v. *Helvering*, 291 U. S. 35, 42.

2. The alternative issue to be presented, if certiorari should be granted, is whether the court below correctly held that the provisions of the separation agreement for support of the wife were not subject to alteration after the divorce decree. In so holding, the court below relied upon *Galusha* v. *Galusha*, 116 N. Y. 635, 138 N. Y. 272, a case decided prior to the enactment of Section 21 of the Domestic Relations Law of 1896 (N. Y. Laws, 1896, Vol. 1, c. 272, p. 220) from which was derived Section 51 applicable here. Sections 1155 and 1170 of the New York Civil Practice Act (see Appendix, *infra*) give the divorce court power to change allowances "at any time after final judgment", and Section 51 of the Domestic Relations Law (Appendix, *infra*) provides that a wife cannot contract

to relieve her husband from his liability to support her. Under these statutes, the effect of such an agreement as the one in the instant case is to fix the amount of the husband's liability but not to discharge his obligation. *Winter* v. *Winter,* 191 N. Y. 462, 473–474; *Fox* v. *Fox,* 263 N. Y. 68, 70; *Tirrell* v. *Tirrell,* 232 N. Y. 224; cf. *Lyeth* v. *Hoey,* 305 U. S. 188, 197.

The separation agreement became merged in the judgment of the divorce court which might thereafter be modified as justice should require. *Kunker* v. *Kunker,* 230 App. Div. 641, 644–645 (3d Dept.). Although the court below said that *Kunker* v. *Kunker* seems "at variance with the law" (R. 154), still that case has been consistently followed by the New York courts.[1] It appears that *Kunker* v. *Kunker, supra,* has been approved or followed in all four departments of the Appellate Division of the New York Supreme Court[2]

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[1] See, for example, *Schnitzer* v. *Buerger,* 237 App. Div. 622, 624 (1st Dept.), and *Staehr* v. *Staehr,* 237 App. Div. 843 (2d Dept.).

See also *Goldstein* v. *Goldsmith,* 243 App. Div. 268, 271 (2d Dept.); *Dworkin* v. *Dworkin,* 247 App. Div. 213, 214 (1st Dept.); *Holahan* v. *Holahan,* 234 App. Div. 572, 574 (4th Dept.); *Severance* v. *Severance,* 235 App. Div. 799 (2d Dept.); *Mandel* v. *Mandel,* 235 App. Div. 821 (2d Dept.).

[2] Although *Kunker* v. *Kunker* may be out of harmony with one of the decisions of the Fourth Department cited by the court below (R. 154), namely, *Cain* v. *Cain,* 188 App. Div. 780, it is probably consistent with the other and later one, *Hamlin* v. *Hamlin,* 224 App. Div. 168, 172.

and that it is consistent with the decisions of the Court of Appeals. It is therefore believed that the court below erred in its interpretation of the New York law and in its decision, even assuming *arguendo* that the taxability of the grantor of a so-called alimony trust necessarily depends upon whether his duty of support has finally been terminated by the divorce decree under applicable state law.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

SEPTEMBER, 1939.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(*a*) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(*a*) *General rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 83. *Gifts and bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance

based on a separation agreement is taxable income. (See article 281.)

ART. 281. *Personal and family expenses.*— * * * Alimony and an allowance paid under a separation agreement are not deductible from gross income. (See article 83.) * * *

New York Civil Practice Act, Book 6:

§ 1155. *Maintenance and support of wife and children in action for divorce by wife*

The court, in the final judgment dissolving the marriage in an action for divorce brought by the wife, may require the defendant to provide suitably for the education and maintenance of the children of the marriage, and for the support of plaintiff, as justice requires, having regard to the circumstances of the respective parties; and, by order, upon the application of either party to the action, and after due notice to the other, to be given in such manner as the court shall prescribe, at any time after final judgment whether heretofore or hereafter rendered, may annul, vary or modify such a direction. But no such application shall be made by a defendant unless leave to make the same shall have been previously granted by the court by order made upon or without notice as the court in its discretion may deem proper after presentation to the court of satisfactory proof that justice requires that such an application should be entertained.

§ 1170. *Custody and maintenance of children, and support of plaintiff in action for divorce or separation*

Where an action for divorce or separation is brought by either husband or wife, the

court, except as otherwise expressly prescribed by statute, must give, either in the final judgment, or by one or more orders, made from time to time before final judgment, such directions as justice requires, between the parties, for the custody, care, education, and maintenance of any of the children of the marriage, and where the action is brought by the wife, for the support of the plaintiff. The court, by order, upon the application of either party to the action, or any other person or party having the care, custody and control of said child or children pursuant to said final judgment or order, after due notice to the other, to be given in such manner as the court shall prescribe, at any time after final judgment, may annul, vary or modify such directions, or in case no such direction or directions shall have been made, amend it by inserting such direction or directions as justice requires for the custody, care, education and maintenance of any such child or children or for the support of the plaintiff in such final judgment or order or orders. But no such application shall be made by a defendant, or any other person or party having the care, custody and control of said infant or infants, unless leave to make the same shall have been previously granted by the court by order made upon or without notice as the court in its discretion may deem proper after presentation to the court of satisfactory proof that justice requires that such an application should be entertained. (Amended by L. 1921, ch. 199; L. 1925, ch. 240, in effect Sept. 1, 1925.)

The last sentence of Section 1170 was omitted by Laws of 1934, c. 521, in effect September 1.

New York Domestic Relations Law (McKinney's Consolidated Laws of New York, Book 14):

> § 51. *Powers of married woman.*—A married woman has all the rights in respect to property, real or personal, and the acquisition, use, enjoyment and disposition thereof, and to make contracts in respect thereto with any person, including her husband, and to carry on any business, trade or occupation, and to exercise all powers and enjoy all rights in respect thereto and in respect to her contracts, and be liable on such contracts, as if she were unmarried; but a husband and wife cannot contract to alter or dissolve the marriage or to relieve the husband from his liability to support his wife. * * *

The foregoing provisions of the Civil Practice Act and the Domestic Relations Law were in force in 1929 when the trust and separation agreements in this case were executed and the divorce granted; and, except as above indicated, those provisions have not subsequently been altered or amended.